Sieps
Swedish Institute for European Policy Studies

European Policy Analysis

NOVEMBER · ISSUE 2013:18epa

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The outer reach of state obligations under deposit guarantee schemes

What can we learn from the Icesave case?

Abstract

On 28 January 2013 the EFTA Court passed a judgment in the so called *Icesave* case, a case which background was the collapse of all the largest banks of Iceland in the autumn of 2008. The case was an infringement case, based on an alleged breach of the EEA Agreement, between the EFTA Surveillance Authority (ESA) and Iceland. The main issue of the case was the question of the level of protection that *Directive 94/19/EC on deposit guarantee schemes*[1], was intended to provide to savers, and, in connection with that, the extent to which a state is to guarantee that deposit guarantee schemes, based on the obligations in the Directive, were fully functional and effective, regardless of the circumstances. The EFTA Court found that Iceland had not failed to comply with the obligations resulting from the Directive. In fact, the outcome of the case seems to reveal some serious shortcomings of EU/EEA rules when it comes to protecting depositors, at the same time as free movement of financial services, across borders, are being reinforced. This analysis aims at shedding a light on the background of the case and the basis of the EFTA Court's conclusion.

1 Introduction

The 'Icesave saga' has its roots in decisions and circumstances that relate to the island of the Viking saga, Iceland. In modern times, however, decisions and actions of economic operators, and even those of politicians, are part of a more complicated environment than they were in the old Viking days. Therefore, when the entire banking system of Iceland collapsed in the autumn of 2008, interesting and challenging legal questions relating to the EEA Agreement and *Directive 94/19/EC on deposit guarantee schemes* emerged. The circumstances and the legal questions were unprecedented, and, therefore, were quite interesting from a purely legal point of view.[2]

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1 Directive 94/19/EC of the European Parliament and of the Council of 30 May 1994 on deposit guarantee schemes, OJ No L 135, 31.5.1994, p. 5. The Directive was incorporated into the EEA Agreement by Decision of the EEA Joint Committee No 19/94 amending Annex IX (Financial Services) to the EEA Agreement of 19 October 1994, OJ No L 325, 17.12.1994, p. 71.

2 In this article we will not cover the highly interesting political aspects of the Icesave case in Iceland, including Iceland's relationship with the EU under the on-going accession discussions, its relationship with its Nordic neighbours and also the Netherlands and the UK (which used its anti-terrorism Act to freeze Landsbanki´s assets in the UK) or the settlement agreements with the Netherlands and the UK, which were twice put to a national referendum. These aspects and stories, as interesting as they are, will have to be told by others.

As with all good sagas, the Icesave saga, or the Icesave dispute as it may also be called, has its origins in important circumstances in the past. First of all, Iceland, along with the EFTA States Norway, Finland, Sweden, Austria and Liechtenstein,[3] became a party to the EEA Agreement[4] in 1994. The EEA Agreement, in brief, extends the rules and principles of the EU internal market to the EFTA States.[5] This means, for example, that the fundamental principles of free movement of services and establishment, and the free flow of capital, are applicable to Icelandic individuals and economic operators, along with the relevant EU secondary law. The second momentous fact was the privatization of the Icelandic state-owned banks, which started in 1997 and was completed at the beginning of the year 2003. The state-owned bank Landsbanki was privatized in 2002. Landsbanki was the largest of the state-owned banks, and, being the country's oldest bank, was a very stable and reputable institution. Therefore, it had good opportunities for extending its activities to other EEA countries.

Soon after the privatization, Landsbanki expanded, and opened offices and invested in established financial institutions in financial centres around the world, such as Luxembourg, London, New York and Frankfurt. The bankers from Landsbanki and the other newly privatized banks in Iceland freely enjoyed the freedoms provided by the EEA Agreement, and cross-border financial services became the cornerstone of the banks' rapid growth. Investments were made in various industries all over the world, with the banking industry being only one of these. However, the Icelandic banks grew tremendously in the years preceding the crisis, and were largely owned by a tight-knit group of businessmen with cross-ownership ties throughout their business empires, who used easy access to capital, quite often in the form of loans from the Icelandic banks, to fuel the growth of their empires to a high degree. It seemed that the time had come for the Icelanders to conquer the (financial) world, the term 'Viking' being more and more frequently used in this context.

However, all was not as it seemed. When the credit crunch started to hurt around international banking, its effects would be felt especially deeply in Iceland. In fact, signs were already visible (at least in retrospect!) in 2006, when it started to become more difficult for Icelandic banks to obtain (re-)finance on the international (mostly European) capital markets. This seems to have given birth to the idea of financing through increased reliance on deposits. In the case of Landsbanki this resulted in the launch of branches in the UK, in May 2006, which offered on-line savings accounts under the brand 'Icesave'. A similar structure with on-line savings accounts was set up in the Netherlands, accepting deposits as of 29 May 2008. These savings accounts became highly successful.

In the autumn of 2008, in a matter of two weeks, as further described below, all the largest Icelandic banks, including Landsbanki on 7 October 2008, collapsed. The Icelandic deposit guarantee scheme turned out to be underfinanced and unable to pay out the minimum guarantee provided for in the Deposit Guarantee Directive 94/19/EC. Who is to be held responsible for this failure? The failed banks and their estates? Or was it a matter for the Icelandic Government, on the grounds that it had failed to make the Directive fully effective in Iceland, under the provisions of the EEA Agreement, so as to secure the deposits in the Icesave accounts when Landsbanki collapsed in October 2008? These questions were at the core of a recent case before the EFTA Court, *EFTA Surveillance Authority ("ESA")* v. *Iceland ("Icesave")*.[6] In that case, as will be further described below, the ESA[7] sought a declaration that, by failing to ensure payment of the minimum amount of compensation to Icesave depositors in the Netherlands and the United Kingdom that was provided for in Article 7(1) of *Directive 94/19/EC on deposit*

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3 Finland, Sweden and Austria became full members of the EU in 1995.

4 Agreement on the European Economic Area, OJ No L 1, 3.1.1994, p. 3.

5 With the exception of Switzerland, which has its own series of bilateral agreements with the EU.

6 Case E-16/11 from 28 January 2013, EFTA Surveillance Authority ("ESA") v. Iceland.

7 The ESA may be seen, within the EFTA pillar, as being broadly equivalent to the EU Commission within the EU pillar. It is an independent surveillance authority for the EFTA States, responsible for ensuring the proper functioning of the EEA Agreement by, among other means, ensuring the fulfilment by the EFTA States of their obligations under the EEA Agreement. The Icesave case was brought before the EFTA Court under Article 31 of the Surveillance and Court Agreement, which provides the ESA with the authority to bring a matter before the EFTA Court if it considers that an EFTA State has failed to fulfil its obligations under the EEA Agreement.

guarantee schemes[8] (hereafter also referred to as the Directive) within the time limits laid down in Article 10 of the Directive, Iceland had failed to comply with its obligations resulting from the Directive, in particular Articles 3, 4, 7 and 10 of the Directive, and/or its obligations under Article 4 of the Agreement on the European Economic Area, which lay down the principle of non-discrimination.

2 The fall of Landsbanki and the emergence of the Icesave dispute

'Icesave' was an online savings account brand owned and operated by Landsbanki from 2006 to 2008. The accounts were first launched in October 2006 in the UK, and in May 2008 in the Netherlands, as stated above. When Landsbanki collapsed, depositors in the UK had deposited around EUR 5.3 billion into Icesave accounts, and depositors in the Netherlands around EUR 1.7 billion.[9]

During the year 2008 it became clear, as was implied above, that the Icelandic banking sector was facing some serious challenges in funding. In September 2008 all the largest Icelandic banks were teetering on the edge of the abyss, and at the start of October 2008 they were finally pushed over, one by one, following the collapse of Lehman Brothers.

On the evening of 6 October 2008 the Icelandic Parliament passed emergency legislation because of the special circumstances in the financial market.[10] The legislation, which took immediate effect, enabled the Icelandic Government to intervene extensively in Iceland's financial system, and allowed the Icelandic Financial Supervisory Authority (hereinafter the 'FME') completely or partially to take over the running of banks and other financial institutions. Up until then Iceland had had a functioning deposit guarantee scheme in accordance with EEA law,[11] as will be further discussed below. However, it was quite clear that the deposit guarantee scheme would not have the financial capacity to guarantee all deposits in a collapse of the magnitude that was faced by the Icelandic economy. Therefore, that same day a statement was issued by the Icelandic Government confirming that deposits in domestic commercial and savings banks and their branches *in Iceland* would be fully covered.[12]

On 7 October 2008 the FME, relying on the emergency legislation,[13] assumed the powers of the shareholders of Landsbanki and immediately suspended the bank's board in its entirety. The bank was placed into receivership. A winding-up committee was appointed which took over all authority of the board of directors with immediate effect.[14]

On 8 October 2008, after having confirmed through conversations with Icelandic ministers that deposits in branches abroad would not be guaranteed in the same way as those in domestic banks and branches, the British Government decided to invoke anti-terrorism legislation[15] to freeze Landsbanki's UK-based assets,

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8 Directive 94/19/EC of the European Parliament and of the Council of 30 May 1994 on deposit guarantee schemes, OJ No L 135, 31.5.1994, p. 5. The Directive was incorporated into the EEA Agreement by Decision of the EEA Joint Committee No 19/94 amending Annex IX (Financial Services) to the EEA Agreement of 19 October 1994, OJ No L 325, 17.12.1994, p. 71.

9 The University of Iceland's Institute on Economic Studies: The Financial Strength of the Deposit Guarantee Scheme. Report no. C12:04. July 2012, pp. 6-7.

10 Act No. 125/2008 on the Authority for Treasury Disbursements due to Unusual Financial Market Circumstances etc. The English version is available under Publications on the official website of the Icelandic Prime Ministry: http://eng.forsaetisraduneyti.is/news-and-articles/nr/3037.

11 Act No 98/1999 on Deposit Guarantees and Investor Compensation Scheme. The English version is available under Legislation on the official website of the Icelandic Ministry of Economic Affairs: http://eng.efnahagsraduneyti.is/laws-and-regulations/nr/1165.

12 'The Government of Iceland underlines that deposits in domestic commercial and savings banks and their branches in Iceland will be fully covered. "Deposit" refers to all deposits by general customers and companies which are covered by the Deposit Division of the Depositors' and Investors' Guarantee fund. Reykjavík, 6 October 2008.' The English version of the statement is available under Publications on the official website of the Icelandic Prime Ministry: http://eng.forsaetisraduneyti.is/news-and-articles/nr/3033.

13 Act No. 125/2008, supra note 9.

14 The English version of the decision is available on the official website of the Icelandic Financial Supervisory Authority: http://www.fme.is/lisalib/getfile.aspx?itemid=6056.

15 Anti-terrorism, Crime and Security Act 2001. The legislation may be found on the official website of the UK National Archives: http://www.legislation.gov.uk/ukpga/2001/24/contents.

including those owned, held or controlled in relation to that bank by the relevant Icelandic authorities or the Government of Iceland.[16] Furthermore, UK Prime Minister Gordon Brown announced that the UK Government would launch legal actions against Iceland.[17]

The Dutch reaction was firm, although not as harsh as that of the British Government, and, on the same day, the Netherlands Central Bank submitted a petition to the District Court of Amsterdam, which ruled on 13 October 2008 that certain emergency regulations were to apply to Landsbanki's branch in the Netherlands.[18]

On 9 October 2008, a new and fully government-owned bank, New Landsbanki, was founded on the basis of the FME decision,[19] to take over the domestic operations of the old Landsbanki. The new bank took over Landsbanki's domestic assets, to ensure the provision of normal banking services and the safety of deposits in Iceland. Domestic depositors thereby had access to their funds and to the full services of the bank at all times. All Landsbanki's international operations were separated. Thus, the deposits in the Icesave accounts, along with all foreign borrowings, remained in the old Landsbanki, to be subject to the winding-up process.[20]

On 27 October 2008, the FME issued the following statement: '*On 6 October 2008, Landsbanki Íslands' hf. […] Icesave websites ceased to work. It is the opinion of the Financial Supervisory Authority (the FME) that on the same day, Landsbanki was unable to render payment of the amount customers demanded, of certain deposits, in accordance with applicable terms. Therefore, with regards to the aforementioned, the Depositors' and Investors' Guarantee Fund […] has become obligated to render payments in accordance with Article 9 of Act No. 98/1999 on Deposit Guarantees and Investor Compensation Scheme, to Landsbanki's customers who did not receive the amount of their deposits.*'[21]

Initially, the The Depositors' and Investors' Guarantee Fund (hereafter the 'Fund') had three months to make payments to depositors in accordance with the law. The deadline for pay-outs was extended several times by the Minister of Economic Affairs, with the final deadline expiring on 23 October 2009.

Instead of waiting to see if the winding-up of Landsbanki would result in payments to the Icesave depositors, whose claims had been given priority over others by the emergency Act,[22] the UK and the Dutch Governments arranged for the Icesave depositors to file claims with the deposit guarantee schemes in their respective countries. The aim was to avoid a potential run on bank deposits in their markets. The UK Government arranged for the pay-out of all retail depositors in full, while the Dutch Government arranged for the compensation of all depositors to a maximum of EUR 100,000.[23]

On 26 May 2010, the ESA initiated infringement proceedings against Iceland, and issued a letter of formal notice to Iceland concerning the Icelandic Government's alleged failure to ensure that Icesave depositors in the Netherlands and the United Kingdom received payment of the minimum amount of compensation provided for in Article 7(1) of the Directive, as amended, within the time limits laid down in Article 10 of the Directive, in breach of the obligations resulting from the Directive and/or Article 4 EEA. Unconvinced by the arguments put forward by the Icelandic Government during those proceedings, the ESA brought the case before the EFTA Court, with an application lodged on 15 December 2011.

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16 The Landsbanki Freezing Order 2008. The legislation is available on the official website of the UK National Archives: http://www.legislation.gov.uk/uksi/2008/2668/contents/made.

17 CityWire Money, 8 October 2008. Available at http://www.citywire.co.uk/money/update-uk-govt-launching-legal-action-against-iceland/a316803.

18 The ruling is available in an English translation at http://www.forsaetisraduneyti.is/media/island/frettir/13.pdf

19 An English press release on the decision is available on the official website of the Icelandic Financial Supervisory Authority: http://www.fme.is/?PageID=580&NewsID=342.

20 The Icelandic Financial Supervisory Authority's news site. 9 October 2008. Available at http://www.fme.is/utgefid-efni/frettir-og-tilkynningar/frettir/nr/443.

21 An English version of the decision is available on the official website of the Icelandic Financial Supervisory Authority: http://www.fme.is/?PageID=582&NewsID=352.

22 Act No. 125/2008, supra note 9, Article 6.

23 Case E-16/11, EFTA *Surveillance Authority v. Iceland*. Report for the Hearing, para. 14.

3 The Case before the EFTA Court

3.1 The relevant EEA and national law

The main legislation at issue in the case is the *Directive 94/19/EC on deposit guarantee schemes* mentioned above.[24] The Directive provides for minimum harmonization rules as regards deposits guarantee schemes, and lays down an obligation on Member States *to ensure* that within their territory there are one or more deposit guarantee schemes 'introduced and officially recognized'.[25] These deposit guarantee schemes should cover the depositors at branches set up by credit institutions in other Member States,[26] and should stipulate that the aggregate deposits of each depositor must be covered up to an amount of EUR 20,000 if their deposits are unavailable.[27] Finally, it is stipulated in the Directive that deposit guarantee schemes must be in a position to pay duly verified claims by depositors in respect of unavailable deposits within three months of the date on which the competent authorities make a determination that the deposits are unavailable.[28]

The Directive was implemented into Icelandic national law by *Act No. 98/1999 on Deposit Guarantees and Investor Compensation Scheme*.[29] The Fund, a private law foundation, was created on the basis of this Act. Commercial banks, savings banks, companies providing investment services, and other parties engaging in securities trading pursuant to the law and established in Iceland, were obliged to be members of the Fund. The same applied to any branches of such parties within the EEA.[30] According to Article 6 of Act No. 98/1999, the total assets of the Fund were to amount to a minimum of 1% of the average value of guaranteed deposits in commercial banks and savings banks during the preceding year. In the event that the assets of the Fund were insufficient to pay the total amount of guaranteed deposits, payments would be divided between the claimants in a certain way, laid down in Article 10 of the Act. Each claim up to ISK 1.7 million[31] was to be paid in full, and any claims in excess of that would be paid in equal proportions depending on the extent of the Fund's assets. Should the total assets of the Fund turn out to be insufficient, the Board of Directors, provided there were compelling reasons to do so, was allowed to seek a loan in order to compensate the claimants for the losses they had suffered.[32]

Moreover, the ESA based its case on the non-discrimination provisions in Article 4 of the EEA Agreement, which stipulates that: *'Within the scope of application of this Agreement, and without prejudice to any special provisions contained therein, any discrimination on grounds of nationality shall be prohibited'*.

3.2 Main arguments of the parties

The ESA's main argument was that Directive 94/19/EC imposed an obligation of result on the EFTA States to ensure that a deposit guarantee scheme was set up capable of guaranteeing the deposits of depositors up to the amount laid down in Article 7(1) of the Directive, and to ensure that duly verified claims by depositors in respect of unavailable deposits were paid within the deadline laid down in Article 10 of the Directive. This meant, in the view of the ESA, that Iceland was obliged not only to set up a deposit guarantee scheme but also to *ensure* that aggrieved depositors were provided with compensation under the conditions prescribed in the Directive. Substantiating this claim, the ESA referred to the wording of Articles 7 and 10, and held that the findings of the EU Court of Justice in the case

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24 *Directive* 94/19/EC, *supra* note 7.
25 *Ibid.,* Article 3.
26 *Ibid.,* Article 4.
27 *Ibid.,* Article 7(1).
28 *Ibid.,* Article 10.
29 Act No. 98/1999, *supra* note 10.
30 Ibid., Article 3.
31 1.7. million was, at that time, the amount equivalent to the EUR 20,000 referred to in Article 10 in Directive 94/19/EC. This amount was linked to the EUR exchange rate on 5 January 1999.
32 *Act No. 98/1999, supra* note 10, Article 10.

of *Paul and others*[33] showed that the Court of Justice held that Articles 7 and 10 of the Directive required a clear and precise result to be achieved. It maintained that the Directive provided for an unconditional right to compensation in the event of deposits being unavailable, claiming that if the guarantee scheme set up under the Directive failed, the EEA State could itself be held responsible for the compensation of depositors to the amount provided for in Article 7 of the Directive. Moreover, the ESA argued that a Member State cannot plead exceptional circumstances to justify non-compliance with the Directive in the absence of a specific provision in the Directive to that particular effect.[34]

Additionally, the ESA submitted that even if, contrary to their argument, the provisions of the Directive were not interpreted to mean that an obligation of result was imposed, it should be seen as a breach of the Directive if there was differentiation between depositors protected under the Directive because protection was provided for some depositors while others had no or no comparable protection. Moreover, the ESA claimed that such differentiation in the treatment of depositors protected by the Directive constituted indirect discrimination based on nationality, which is prohibited by Article 4 of the EEA Agreement.[35]

Iceland´s main arguments were that the Directive imposed no obligation of result on an EEA State to use its own resources in order to guarantee the pay-outs of a deposit guarantee scheme in the event that the scheme failed. It maintained that the obligations incumbent upon the State were limited to ensuring the proper establishment, recognition and, to a certain degree, supervision of a deposit guarantee scheme.

The Icelandic Government emphasized that no provision of the Directive suggested that any form of state guarantee or state funding was required under the Directive, and that certain paragraphs in the preamble to the Directive made it clear that the funding for deposit guarantee schemes would come from the banks. Furthermore, no deposit guarantee scheme could have coped with such a wide-scale banking failure as that experienced by Iceland, and the interpretation of the Directive proposed by the ESA would create serious risks and burdens on the EEA States, beyond their contemplation when the Directive was adopted, be that with regard to the national banking system or with regard to consumer protection.

In terms of the ESA's claims regarding breach of Article 4 EEA, the Icelandic Government argued that there had been no discrimination whatsoever in the manner in which the deposit guarantee fund operated, and that the two groups compared by the ESA, depositors with accounts in domestic branches and depositors with accounts in foreign branches of Landsbanki, had been treated equally.[36] However, the domestic depositors were covered by virtue of a transfer of their deposits into a new bank which was part of a restructuring

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33 Case 222/02, *Peter Paul and others v. Bundesrepublik Deutschland*, [2004] ECR I-09425. In this case a German bank became insolvent and depositors were unable to receive compensation from the deposit guarantee scheme established in Germany. The bank had not been granted membership of the German guarantee scheme, but had still been granted a licence to accept deposits. The case concerned Germany's responsibility for deposits exceeding the amount provided for in Article 7(1) of Directive 94/19/EC. The case is the only existing case in this field. The ESA mainly relied on the following paragraphs of the judgment: Para 26: *"In that regard, it should be borne in mind that Directive 94/19 seeks to introduce cover for depositors, wherever deposits are located in the Community, in the event of the unavailability of deposits made with a credit institution which is a member of a deposit guarantee scheme. Para 27: "The depositor's right to compensation in such a situation is governed by Article 7(1) and (6) of that Directive. Article 7(1) determines the maximum amount of compensation which a depositor may claim on the basis of the directive, whilst Article 7(3) specifies that Member States may under their national law provide for rules offering depositors a higher or more comprehensive cover for deposits. Article 7(6) of Directive 94/19 requires Member States to ensure that the depositor's rights to compensation, as defined in particular in Article 7(1) and (3), may be the subject of an action by the depositor against the deposit guarantee scheme."*

34 Case E-16/11, *supra* note 5, para. 81.

35 It should be duly noted that in this case the European Commission, exercising its rights according to Article 36 of Protocol 5 to the SCA (EFTA Surveillance and Court Agreement) on the Statute of the EFTA Court, for the first time requested leave to intervene in a case before the EFTA Court in support of the ESA. Its arguments in the intervention will not be discussed separately here as they were, in all main issues, the same as those of the ESA, but the importance of the Commission's intervention with regards to the weight of the case cannot be dismissed.

36 Case E-16/11, *supra* note 5, paras. 199-200

scheme aiming at salvaging the Icelandic financial system.[37] Finally, the Icelandic Government maintained that even if there had been any difference in treatment between the two groups, such a difference would have to be seen as being in the public interest and thus objectively justified.[38]

4 The Judgment of the EFTA Court

The Court itself summarized its task, in terms of the ESA's first plea, as assessing whether, in a systemic crisis of the magnitude experienced in Iceland, the Directive itself envisaged that the Icelandic Government should have ensured payment to depositors in the Icesave branches in the Netherlands and the United Kingdom in accordance with the provisions of the Directive, and including an assessment of whether the Icelandic Government had failed to fulfil an 'obligation of result'.[39] For the sake of clarity, the discussion is here divided into three general categories: in the first, the Court dealt with the provisions of the Directive (Articles 3, 7 and 10); in the second, the Court looked thoroughly at the recitals of the Directive; and in the third, the Court dealt with the issue of discrimination within the Directive or on the basis of Article 4 EEA.

4.1 Articles 3, 7 and 10 of the Directive

The Court's first task was to analyse Article 3 of the Directive, from which it follows that an EEA State is under an obligation to *ensure* that, within its territory, one or more deposit guarantee schemes are 'introduced and officially recognized'.[40] The Court highlighted the fact that the system provided for in Article 3 was not one of absolute constraints, and that the Directive did not exhaustively regulate on the unavailability of deposits under EEA law, but said that it required EEA States to provide for a harmonized minimum level of deposit protection. Therefore, in the view of the Court, it was clear that national authorities have considerable discretion in how they organise schemes. The EEA States were to introduce and officially recognise a deposit guarantee scheme, and to fulfil certain supervisory tasks in order to ensure the proper functioning of that scheme. In the view of the Court, it was, however, not envisaged in Article 3 of the Directive that EEA States were to 'ensure the payment of aggregate deposits in all circumstances'.[41]

Next the Court analysed Article 7(1) of the Directive, which states that 'Deposit-guarantee schemes **shall stipulate** that the aggregate deposits of each depositor must be covered up to ECU 20,000 in the event of deposits being unavailable'.[42] The Court pointed out that the wording of Article 7(1) of the Directive has been amended by Directive 2009/14, with the new version stating that 'Member States **shall ensure** that the coverage for the aggregate deposits of each deposit shall be at least EUR 50,000 in the event of **deposits being unavailable'**.[43] In the opinion of the Court, this shows that the European legislature thought that substantial changes were necessary to extend the responsibility of the EEA States beyond that of the establishment of an effective framework. Moreover, the Court pointed out that Article 7(6) of the Directive provides an obligation for the EEA State to make sure that a depositor's right to compensation may be the subject of an action by the depositor against the guarantee schemes, thus anticipating the scenario that the scheme might be unable to pay duly qualified claims. In the view of the Court, the obligation of the State does not reach so far, under the Directive, as to ensure compensation if the deposit guarantee scheme is unable to cope with its obligations 'in the event of systemic crisis'.[44]

In the view of the Court, the same holds for an analysis of the obligations under Article 10 of the Directive, which in the view of the Court, is limited only to requiring a mandatory and effective procedural framework with respect to time limits.[45]

4.2 The Recitals of the Directive

Following the analysis of these provisions, Articles 3, 7 and 10, the Court went into a long and detailed analysis, mainly of the recitals of the Directive, and looked at

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37 *Ibid.*, paras.197-198.
38 *Ibid*., para. 201.
39 *Ibid*., para. 117.
40 *Ibid,* para. 135.
41 *Ibid.*, paras. 130-135.
42 Emphasis added.
43 Emphasis added.
44 Case E-16/11, *supra* note 5, quote from para. 144, rest from paras. 136-144.
45 *Ibid.*, para. 149.

the aim and scope of the Directive from various angles. First, the Court pointed out that Articles 1(3) and 9(3), and recitals 3, 4, 10 and 25 in the preamble to the Directive, show that the Directive, at least primarily, is dealing with the anticipated failure of **individual banks** – not with a systemic crisis.[46]

Secondly, in relation to recital 4, the Court also pointed out that the Impact Assessment Reports, published by the EU Commission in 2010 and therefore written in the light of the financial crisis of 2007/2008, only envisaged, as the biggest failure, the failure of a large member bank, accounting for 7.25% of eligible deposits, but not a systemic bank failure of the magnitude experienced in Iceland. Moreover, the Court pointed out, the mechanisms and levels of funding of deposit schemes are not laid down or harmonized in the Directive.

Thirdly, the Court pointed out that it is clear from recital 23 of the Directive that the cost of financing is to be borne by the credit institutions, not by the EEA States. At the same time, this recital aims at striking a balance between the cost of funding, the stability of the national banking system and consumer protection. Therefore, if a systemic crisis were to be met by the system, the cost of the maximum coverage level would clearly undermine the stability of the banking system itself. However, the Court pointed out that the Directive holds no answers to the question of what should be done if a guarantee scheme were to be unable to cope with its payment obligations. If an *EEA State* were obliged to ensure that compensation was paid in these circumstances, there would be negative effects on competition comparable to those the Directive expressly aims to minimise in Article 3(1), where it says that "the system must not consist of a guarantee granted to a credit institution by a Member State itself or by any of its local or regional authorities".

Such an obligation would have had to have been expressly stated in the Directive. However, the Court pointed out that that does not necessarily mean that depositors will remain unprotected, since they may benefit from other provisions of EEA law regarding financial services.[47]

Fourthly, the Court made a reference to the concept of *moral hazard*, in the context of recital 16 of the Directive, which states that it would not be appropriate to impose 'a level of protection which might in certain cases have the effect of encouraging the unsound management of credit institutions'. In this context the Court made reference to Professor, and Nobel Prize winner, Joseph E. Stiglitz, who has stated: '[T]he more and better insurance that is provided against some contingency, the less incentive individuals have to avoid the insured event, because the less they bear the full consequences of their actions'.[48] The Court pointed out that a state guarantee, or state funding of deposit guarantee schemes, would immunize the members of the scheme from the costs which have, in principle, to be borne by them.[49]

Fifthly, citing recitals 2 and 3 of the Directive, the Court stated that the alleged obligation of result would run counter to the aims there mentioned, according to which consumer protection is to be achieved by means of the introduction of a minimum level of deposit protection, and the guarantee that foreign and domestic deposits are protected by the same guarantee scheme irrespective of where a credit institution has its head office.

Lastly, the Court asked if the obligation of result may be supported by recital 24, which states that the 'Directive may not result in the Member States or their competent authorities being made liable in respect of depositors if they have ensured that one or more schemes guaranteeing deposits or credit institutions themselves and ensuring the compensation or protection of depositors under the conditions prescribed in this Directive have been introduced and officially recognized'. The Court notes that this reservation is aiming expressly at precluding an excessive shifting of the costs arising from a major banking failure to the State, and, therefore, this recital does not support the existence of the alleged obligation of result.

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46 *Ibid.,* para. 151.

47 *Ibid.,* para. 161.

48 ("Risk, Incentives and Insurance: The Pure Theory of Moral Hazard", The Geneva Papers on Risk and Insurance, 8 (No 26, January 1983), 4, at p. 6.) This is the first time that the EFTA Court has made such a reference in a judgment. This type of reference is, of course, common in opinions of the Advocate Generals of the Court of Justice, but not in judgments of the Court of Justice itself.

49 Case E-16/11, *supra* note 5, paras. 167-8.

In light of the above, the Court dismissed ESA's first plea regarding the Icelandic Government's failure to fulfil an obligation of result deriving from the Directive.

4.3 The Issue of Discrimination

As concerns the pleas on **discrimination**, these were mainly dismissed by the Court on the basis of the factual circumstances of the case, i.e the fact that, on the basis of the FME decision of 9 October 2008, domestic deposits were transferred to New Landsbanki which was established by the Icelandic Government **between 9 and 22 October** 2008. However, the Icelandic Insurance Fund TIF was not involved in the transfer of the deposits, since the transfer was part of the restructuring of the Icelandic banks that was achieved by a series of measures under the Icelandic Emergency Act. The Court pointed out that on 27 October 2008, that is, within the 21 days prescribed in Article 1(3) of the Directive, the FME made a statement that triggered an obligation for the TIF to make payments as regards **foreign** deposits in branches of Landsbanki. However, **domestic** deposits did not become unavailable within the meaning of Article 1(3) of the Directive. The transfer of domestic deposits to New Landsbanki was made before the FME made its declaration triggering the application of the Directive. Accordingly, depositor protection under the Directive never applied to depositors in Icelandic branches of Landsbanki. In this light, the Court concluded that a difference in treatment, on the basis of the principle of non-discrimination inherent in the Directive, was not possible.

In respect to a *per se* breach of Article 4 EEA, the Court emphasised that the principle of non-discrimination required that comparable situations should not be treated differently, and that different situations should not be treated in the same way. Additionally, the Court highlighted the fact that the ESA had limited the scope of its application by stating that the case did not concern whether Iceland was in breach of the prohibition on discrimination for not moving over the entirety of the deposits of foreign Icesave depositors into New Landsbanki as it did for the deposits of domestic Landsbanki depositors. Moreover, the ESA held that compensation of domestic and foreign depositors above and beyond that minimum amount was not to be discussed in the context of the proceedings.

However, since the Court had already held that the Directive, even read in the light of Article 4 EEA, imposed no obligation on the defendant, it found that such an obligation of result could only be deemed to exist if it followed directly from Article 4 EEA itself. The Court held that a specific obligation of result, which would require the Icelandic Government to ensure that payments were made in accordance with the requirements of the Directive to Icesave depositors in the Netherlands and the United Kingdom, was not required under the principle of non-discrimination. The Court pointed out that, in any event, such a specific obligation upon the Icelandic Government would not even establish equal treatment between domestic depositors and those depositors in Landsbanki's branches in other EEA States.

Interestingly, also, as a final word, and *obiter dictum*, the Court stated the following: 'For the sake of completeness, the Court adds that even if the third plea had been formulated differently, one would have to bear in mind that the EEA States enjoy a wide margin of discretion in making fundamental choices of economic policy in the specific event of a systemic crisis provided that certain circumstances are duly proven. This would have to be taken into consideration as a possible ground for justification. In the earlier case of *Sigmarsson*, the applicant itself underlined this point'.

5 Comments

The major issue in this case is the question of the level of protection that the Directive 94/19/EC on deposit guarantee schemes was intended to provide, and, in connection with that, the extent to which a state is to guarantee that deposit guarantee schemes, based on the obligations in the Directive, are fully functional and effective, regardless of the circumstances.

As the Court clearly pointed out, the Directive does not stipulate in a clear and precise manner that the State shall function as a 'back-up' in case of need, or be responsible for the scheme functioning fully if all its major contributors fail at the same time (systemic crisis). Such a clear and precise stipulation of an obligation of result is an undeniable prerequisite for State's liability, as maintained by the ESA in this case. The Court in fact, came to the contrary conclusion,

namely that the Directive is silent on what is to happen in the case of systemic crisis.[50]

On the point regarding the actual and clear wording of the Directive, it is of course an important factor that the EU legislator has deemed it necessary to reinforce the role of the State in its amendments in Directive 2009/14/EU, amending the wording of Article 7(1) of the Directive with the wording, 'Member States shall ensure that the coverage for the aggregate deposits of each deposit shall be at least EUR 50,000 in the events of deposits being unavailable …', instead of the previous, clearly more abstract, obligation, 'Deposit-guarantee schemes shall stipulate…'. Other changes have also been suggested in the new EU Commission legislative proposal of 12 July 2010,[51] which introduced, for example, the 'mutual borrowing facility' where schemes in need may borrow from all other schemes in the EU, which, together, **must**, if necessary, lend to the other scheme, each up to a maximum of 0.5 % of its eligible funding. Moreover, cases such as the one of *Icesave*, where branches in the UK and the Netherlands were operating on the basis of the Icelandic deposit guarantee scheme (home scheme), would in the future be dealt with differently *vis-à-vis* the depositors, since the host schemes (which in the *Icesave* case would have been the schemes in the UK and the Netherlands) would be responsible for communication with depositors as well as acting as paying agents on behalf of the home scheme, which in turn would reimburse the host scheme.[52]

It is clear that it may be challenging to reconcile the aims of the Directive, the protection of savers and the free movement of financial services. However, the changes adopted, and the suggested amendments, of course bring forward the obvious and at the same time disturbing question of whether Directive 94/19/EC was fully equipped to sustain cross-border banking services, particularly where small state banks, operating on the basis of small state schemes, were allowed to open up branches in other (bigger) countries and receive deposits from individuals and economic operators on a large scale. It appears that few if any deposit guarantee schemes in the whole of the EU were equipped to meet a *systemic crisis*, or even a medium-sized bank failure.[53] Therefore, it seems to us that the Directive fell short of fulfilling its aim of securing deposits in a situation of cross-border banking, particularly in the situation described above. The amendments and the latest proposal support such a conclusion, especially if we draw into that picture the ideas of pan-European deposit guarantee schemes which the EU Commission has put forward as the future goal, although a long-term project.[54] In our view, and in the light of the disturbances to depositors in Europe to which the current system has led, such a pan-European solution seems a practical solution, and the only sensible corollary of cross-border retail banking.[55]

The amendments adopted on the EU side will somewhat limit the impact of the *Icesave* ruling as precedent for the EU and the Court of Justice, particularly for the future, due to the nature and extent of the amendments. However, this by no means suggests that its legal importance should be dismissed. Indeed, the judgment of the EFTA Court is final and is only binding in Iceland, Norway and Liechtenstein, the three EFTA countries; it does not directly bind the Court of Justice of the European Union or the EU States. However, judgments of the EFTA Court have had an impact on the jurisprudence in the EU system.[56] Additionally,

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50 *Ibid.,* para. 144.

51 Draft EU Commission proposal for a Directive on Deposit Guarantee Schemes. Available at http://ec.europa.eu/internal_market/bank/docs/guarantee/20100712_proposal_en.pdf.

52 *Ibid.,* Article 12.

53 See Commission Report on Deposit Guarantee Schemes´ efficiency, of May 2008, at pp. 61-2, available at http://ec.europa.eu/internal_market/bank/docs/guarantee/deposit/report_en.pdf and Commission Staff Working Document of 12 July 2010, (SEC(2010) 834/2)p. 5 and p. 20, available at http://ec.europa.eu/internal_market/bank/docs/guarantee/20100712_ia_en.pdf

54 See the 2010 Commission review of the Deposit Guarantee Schemes available at http://ec.europa.eu/internal_market/bank/docs/guarantee/20100712_report_en.pdf

55 This view seem not to be shared by all EU heads, at least not the German Chancellor Angela Merkel see http://www.euromoney.com/Article/3197194/Germanys-rejection-of-a-pan-European-deposit-guarantee-scheme-is-no-disaster.html

56 See e.g. Eleanor Sharpston and Michael-James Clifton "Two EEA Courts – Unequal Balance or Fruitful Partnership?" in Judicial Protection in the European Economic Area (EFTA Court ed.), (German Law Publishers, 2012) pp. 170-186 and Carl Baudenbacher, "The EFTA Court Ten Years On", in C. Baudenbacher, P. Tresselt and T. Örlygsson (eds.) The EFTA Court Ten Years on (Hart Publishing, 2005), at pp. 48 et seq.

the judgment is bound to influence the debate on the reforms that have to be made in this field within that system, and how those reforms have to be formulated in order to serve their purpose. In that light, all the discussion and reasoning in the judgment concerning the role and capability of the Directive in dealing with systemic crisis remains good and valid, since that question remains unresolved at the EU/EEA level.

Finally, the possible effect of the Court's final passage, in its reasoning on ESA's discrimination plea, must not be overlooked. After coming to the conclusion that no discrimination had taken place, based on either the Directive or Article 4 EEA, the Court made a statement on what it deems to be the correct understanding of the law on what can constitute an objective justification of discrimination. The Court's *obiter dictum* is to be found in the final paragraph, where the Court states *inter alia* that 'the *EEA* States *enjoy a wide margin of discretion* in making fundamental choices of economic policy in the specific event of a *systemic crisis* provided that certain circumstances are duly proven'.[57] This statement, which cannot be seen as necessary for the outcome of this particular case, can certainly become influential with regards to the possible line of argument for both EU and EEA EFTA states when it comes to defending the policy choices made when dealing with the on-going crisis and its aftermath.

This political importance and the sensitivity of the matter is also reflected in the Court's extensive discussion and reasoning related to the various recitals of the Directive. At first sight, one cannot help but wonder what pushed the Court to this rather non-traditional approach. The most influential reasons are most likely to be related to the nature of the case and the ESA´s pleas in terms of *obligation of result*, and the fact that all the parties made frequent references to the recitals in their arguments. Since it accepted neither the ESA´s arguments, nor those of the EU Commission and the intervening EU Member States, it is understandable that the Court would want to support the conclusions diligently. In this regard one should also highlight that the EFTA Court has no Advocate Generals, and might therefore, for the sake of clarity and coherency, be forced to give more detailed information and background to its reasoning. This might also explain the Court's references to literature which, until then, had, for the EEA courts, only been seen in opinions of Advocate Generals to the EU's Court of Justice.[58] Additionally, it must be kept in mind that there is practically no case law in this field, not much has been written in the legal literature and, indeed, the making of claims for compensation from deposit guarantee schemes in times of systemic crisis is fortunately not something that happens every day.[59]

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[57] Emphasis added by the authors.

[58] It is worth noting that the Supreme Court of Iceland never makes such references to external literature, but this, however, is a well-known practice in the Supreme Court of Norway and the Supreme Court of Sweden.

[59] The issues brought forward in this case have not directly been dealt with by the Court of Justice of the European Union ('the Court of Justice' or 'the Court'). However, in its judgment from 25 April 2013, in the case C-398/11 (Hogan and others vs. Minister for Social and Family Affairs, Ireland), the Court of Justice dealt with issues concerning the transposition in Ireland of Article 8 of Directive 2008/94/EC, on the protection of employees in the event of the insolvency of their employer ('the Insolvency Directive'). In that judgment the Court came to the conclusion that certain measures adopted by Ireland in transposing Article 8 of the Insolvency Directive did not fulfil the obligations imposed on it to protect employee benefits in the event of the insolvency of their employer. In its judgment the Court expressly stated that the economic situation of a Member State did not constitute an exceptional situation capable of justifying a lower level of protection for employee benefits (para. 47). At first sight it might seem as in this judgment the Court rebuked the EFTA court's judgment in the Icesave case. In our view however, it is doubtful if the similarities of these two cases are enough in order to draw any far reaching conclusions. Firstly, a pension scheme and a deposit guarantee scheme are very different both in purpose and in nature and the same can be said about the different status of the savers they are supposed to serve. The risk of chain-reactions, or systemic crisis, are also of entirely different scale, in relation to deposit guarantee schemes, and the insolvency of their contributors vis-à-vis that of employee benefit guarantee fund. Secondly, the Court never so much as mentioned the Icesave judgment in the Hogan case, which it most certainly would have, and should have done, if the outcome was intended to limit the influence of the EFTA Court's decision. We are therefore of the opinion, that the Hogan judgment, should not be viewed as an direct or an indirect overruling of the EFTA Court´s ruling in the Icesave case.

Even if the *Icesave* judgment of the EFTA Court ended with the Icelandic Government not being found guilty of the ESA's claims, the Icesave saga continues. As was mentioned in Section 2 above, the Emergency Act[60] gave priority to the Icesave depositors' claims to the estate of the old Landsbanki. Throughout the dispute the Winding-up Board of the estate has maintained that it would, in the end, be able to meet the claims of the priority creditors in full. To date the Winding-up Board has paid over ISK 660 billion in aggregate in three partial payments, or around half the claims of priority creditors in accordance with the Icelandic Bankruptcy Act. Furthermore, the Winding-up Board still maintains that the estate's assets amount to more than ISK 200 billion more than what is needed in order to fully reimburse all priority claims.[61]

It is clear that the *Icesave* case was initiated during politically and financially sensitive times when the whole of Europe was facing a financial crisis of an unknown scale. No one could anticipate the outcome of the case in full, nor the potential financial liabilities related to it.[62] No court is entirely immune from the political and financial sensitivity of cases, but in our view the *Icesave* case seems instead to be a saga of financial Vikings conquering savers in foreign countries, on the basis of EU/EEA rules which had serious shortcomings when it came to protecting the savers. In the light of recent and forthcoming substantial legislative amendments in the field of financial services, it seems safe to conclude that the European legislature agrees.

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[60] Act No. 125/2008, supra note 9, Art. 6.

[61] An Announcement on LBI hf. Website. Available at http://www.lbi.is/home/news/news-item/2012/11/28/Announcement-from-Landsbanki-Islands-hf.-----Creditors meeting/-estimated value of LBI's assets is therefore about 200 bn higher than estimated priority claims.

[62] Of course the *Icesave* case itself was not about any financial claims directly, since that issue would only need to be solved if it had been established that there had been an infringement of the EEA Agreement, either through a State liability case, or through other avenues given the international dimension of the case.